No. 15073.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

DESSER, RAU & HOFFMAN and JACK L. RAU, individually,
Appellants,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of Stockholders Publishing Company, Inc., a bankrupt,
Appellee.

APPELLEE'S BRIEF.

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APPELLEE'S BRIEF.

Statement of the Case.

The facts in this case are uncomplicated. A clear understanding of these facts will make eminently clear why there could have been no other result than that reached by both the Referee and the District Court.

An Involuntary Petition in Bankruptcy was filed against Stockholders Publishing Company, the bankrupt corporation, on December 31, 1954. Stockholders Publishing Company had been publishing the Daily News, a metropolitan daily paper in Los Angeles, and had terminated its operation approximately two weeks previously, on December 18, 1954.

Prior to the commencement of the bankruptcy proceeding, the firm of Desser, Rau and Hoffman, Appellants herein, acted as attorneys for the bankrupt corporation. Arthur Desser, one of the partners in said firm of attorneys, was an officer of the bankrupt corporation during

December, 1954, as well as many months prior thereto. At a meeting of the Board of Directors of the bankrupt corporation held on December 18, 1954, the Board authorized the termination of operation and also authorized the president of the corporation to institute bankruptcy proceedings. Arthur Desser was present and participated in such meeting.

After ceasing its operation on December 18, 1954, the bankrupt corporation determined that it needed access to a new bank account for the protection of its incoming funds and for the making of certain essential disbursements from said funds. For this specific purpose, on December 20, 1954, Appellants, Desser, Rau and Hoffman, acting as attorneys for the bankrupt corporation and on behalf of the bankrupt corporation, opened at the Union Bank & Trust Company of Los Angeles a bank account designated as "Jack L. Rau, Special Account." In such bank account there was deposited by the corporation certain funds belonging to the corporation, and out of said account certain disbursements were made on behalf of the corporation.

With reasonable promptness after the commencement of the bankruptcy proceedings, Appellants rendered an accounting of the receipts and disbursements on said Special bank account to George T. Goggin, the Receiver, at which time the account contained the sum of $16,163.15. Appellants remitted to the Receiver the sum of $12,945.47, and retained in said Special account the sum of $3,217.68. This latter sum is the fund which is the subject matter of this litigation and this appeal.

Appellants claim, and the Trustee did not dispute, that in the year preceding December 18, 1954, Appellants had expended from their own funds on behalf of the bankrupt

corporation the sum of $3,217.68 for various expenses on behalf of the bankrupt corporation.

The instant proceeding was commenced by the filing by Appellants on January 21, 1955, of a Petition praying that the Referee make an Order authorizing Appellants to pay to themselves out of said Special account said sum of $3,217.68, to reimburse Appellants for cash advances made on the bankrupt's behalf in the year prior to December 18, 1954. The Referee held that it was clear that Rau held the moneys in the Special account as trustee or agent of the bankrupt corporation and did not acquire any other interest in this fund. The Referee held that the moneys in this bank account constituted property of the bankrupt corporation.

The Referee held that, as the fund in controversy constituted property of the bankrupt, this was not a matter within the provisions of Section 68a of the Bankruptcy Act, providing for set-offs in the cases of mutual debts or mutual credits between the estate of the bankrupt and a creditor. The District Court, upon review of this matter, not only approved and affirmed the Order of the Referee, but approved and adopted the Referee's Findings of Fact and Conclusions of Law.

The facts and the law of this case are so simple that the fact that the matter has now been taken on appeal to the Court of Appeals has alarmed this conservative counsel for the Trustee into a careful re-examination of the entire proceeding. Because of the obvious industry which has been put into the matter both below and on this appeal by counsel for Appellants, it can not really be said that this appeal is frivolous; yet the absence of a direct relation between the law argued by Appellants and the facts of the case presents Appellee an unusual problem.

ARGUMENT.

Appellants present what is ostensibly a three-point legal argument to support their theory upon appeal:

1. That the subject sum of $3,217.68 is a debt owing from Appellants to the bankrupt, which debt Appellants are entitled to set off against the obligation owing to Appellants by the bankrupt, by virtue of Section 68a of the Bankruptcy Act.

2. That Rule 13 of the Federal Rules of Civil Procedure broadens the meaning of Section 68a and thereby increases the rights of a creditor asserting set-off.

3. That there was some transfer by the bankrupt to Appellants, which transfer was not a voidable preference.

I.

The Sum Retained in the "Jack L. Rau Special Account" Was a Trust Fund, Property of the Bankrupt, Which Jack L. Rau Held as Trustee for the Bankrupt (and Not as Agent for Appellants) and Therefore Appellants Have Absolutely No Right to Set Off Such Amount Against a Debt Owing by the Bankrupt to Them.

The undisputed facts disclosed that on the date of bankruptcy Jack L. Rau was the Trustee of certain funds which were the property of the bankrupt corporation. The provisions of Section 68a of the Bankruptcy Act are in no way applicable.

Appellants state as follows in their brief (p. 10):

> "It is *admitted* that at the time of the filing of the Petition in Bankruptcy Appellants *owed* the bankrupt the balance in a special fund. . . ." (Emphasis added.)

Appellants are the only ones doing such "admitting", and their use of the word "owed" underlines their continuing basic misconception of the simple situation herein presented. However, this completely unwarranted use of the term "owed" is quite essential in the effort by Appellants to establish some basis to talk about Section 68a. The principal case cited by Appellants to support this phase of their theory is this Court's decision in *Half Moon Fruit & Produce v. Floyd,* 60 F. 2d 799. This Court will recall that in the *Half Moon* case a commission merchant who had made seasonal cash advances to a grower to enable him to produce his crop was held to be entitled to an equitable lien on melons consigned to him by the grower, and entitled to a "mutual credit" in the "set-off"sense for such advances against the proceeds of the sale of the melons. Appellee does not see just how such case can be made to support a contention by a trustee of a special bank account that he is entitled, after bankruptcy, to have transferred to a partnership in which he is interested a portion of that account to satisfy an antecedent unsecured obligation owing to said partnership by the bankrupt.

The law is clear that where the liability of one claiming a set-off arises from a fiduciary duty or is in the nature of a trust, the requisite mutuality of debts or credits does not exist, and such person may not set off a debt owing from the bankrupt to such liability.

4 Collier on Bankruptcy (14th Ed.) 726.

The United States Supreme Court long ago made a definitive statement on this point in the case of *Western Tie & Timber Co. v. Brown,* 196 U. S. 502, 49 L. Ed. 571, which case has been respected and followed since.

In the *Western Tie* case, the tie company and Harrison, the bankrupt, had been engaged in removing timber from the tie company's land, etc. The bankrupt operated stores, patronized by laborers of the tie company. The tie company deducted from the payroll the amount owed by the laborers to the bankrupt for purchases. Against a $24,000.00 debt owed to it by the bankrupt the tie company attempted to set off $2,210.73 collected from payrolls and held for the bankrupt. The United States Supreme Court said that the creditor could not set this off. The creditor was in a position of a trustee and therefore the case was not one of mutual credits and debts within the meaning of the set-off clause of the Bankruptcy Act.

See, also:

Arkansas Fuel Oil Co. v. Leisk, 133 F. 2d 79, following the law of the *Western Tie* case.

A recent case in point is that of *In re Zuckerman* (D.C. N.Y. 1955), Commerce Clearing House Decisions, par. 58,303, where the Court held that a landlord may not set off a sum deposited with him as security for the performance of a lease, against a debt owing by the bankrupt for unpaid rent.

This court, in a 1956 ruling on the applicability of Section 68a, held that where a bank account is impressed with the character of a trust fund, even the creditor bank could not assert a right of set-off.

First National Bank of Portland v. Dudley, 231 F. 2d 396 (C. A. 9, Mar. 13, 1956).

In the latter case, the bank had joined other creditors of the bankrupt in a pre-bankruptcy extension arrangement, pursuant to which proceeds from liquidation of the bankrupt's inventory were to be applied toward payment of all claims on an equal basis; and the Court held that the bank account created by such proceeds was impressed with the character of a trust fund. The bank not only was refused a right of set-off, but was estopped to assert the usual banker's lien.

When the facts of the instant case are re-examined it can be seen just how inappropriate any application of Section 68a would be.

The bankrupt owed money to Appellants. The Appellants assert a "set-off" to such debt. They have, they say, a "mutual debt" owing by them to the bankrupt which they wish to so set off. Where and what is this "debt"? Perforce, it must be, somehow, in the funds held by Jack L. Rau in the "Jack L. Rau, Special Account", a trust account admittedly set up on behalf of the bankrupt corporation, with funds of the bankrupt corporation only, and solely for purposes of the bankrupt.

At what point does a debt from Appellants to the bankrupt appear? No one has ever asserted that Jack L. Rau violated his trust and transferred any part of such funds to Appellants. No one has ever asserted that Jack L. Rau silently changed his status from that of trustee for the bankrupt to that of agent of Appellants. On the contrary. Mr. Rau's conduct appears to have been quite proper, and consistent with his duties as trustee. He filed an account-

ing with the Receiver and the Bankruptcy Court and stated that he still retained in the special account the subject sum of $3,217.68. [Petition to Allow Payment of Expenses, Tr. 4.]

There obviously was no transfer of funds from the bankrupt to Appellants. (And for this reason, no preference. See *infra.*) Appellee simply cannot bridge the gap in Appellants' argument at the vague point where the fund in the trust account becomes, in the course of Appellants' discussion, a general indebtedness of Jack L. Rau (and hence of Appellants, the firm of Desser, Rau & Hoffman) to the bankrupt corporation. No transfer, merely a transformation! Possibly a chemical reaction induced by the injection of one petition in involuntary bankruptcy.

Appellants state (App. Br. p. 31) that they and Jack L. Rau, at the date of bankruptcy, "owed" the bankrupt $16,163.15. And to Appellants, whether they "owed" this sum as an ordinary debtor or as a trustee "makes no difference." This theory is the heart and the entirety of Appellants' position on this appeal, and on this theory Appellants must fail.

II.

Appellants' Discussion of the Federal Rules of Civil Procedure Is Inappropriate and Irrelevant.

No issue concerning the applicability of Rule 13 of the Federal Rules of Civil Procedure was before the Referee or the District Court.

Furthermore, Appellants have not suppported their general discussion on this point with a single case relating either to Section 68a or the case at bar.

III.

There Was No Transfer From the Bankrupt to Appellants and Therefore No Preference. If Appellants Had Received Such Fund From the Bankrupt, Such Transfer Would Have Been a Voidable Preference Under Section 60 of the Bankruptcy Act.

Appellants, both in the argument before the District Court and in their brief herein (pp. 30-40) have created quite a straw man as to the issue of "voidable preference," but even then do not succeed in knocking their man down. With all due respect to counsel for Appellants as well as to this Court, it is submitted that the discussion in Section II Appellants' brief (pp. 30-40) on the subject of bankruptcy preference as related to the facts of this case constitutes legal double-talk. There was no transfer; therefore there could be no preference.

In their original petition before the Referee [Petition to Allow Payment of Expenses, Tr. 3 *et seq.*] Appellants asserted that on January 5, 1955, the trust account "contained the sum of $16,163.15," that $12,945.47 had since been remitted to the Receiver, and that there remained in the account the subject sum of $3,217.68. They petitioned the Court for an order authorizing payment of this sum to them from said account. Appellee sees no transfer.

But permit us to run with Appellants' football for a moment. If by some means, Appellants had received funds of the bankrupt corporation corporation via moneys placed into the Special Account, what would be the effect of Section 60a of the Bankruptcy Act? The transfer would be on December 20, 1954, or later. The bankrupt was indebted to Appellants on an antecedent obligation in the sum of $3,217.68. This antecedent obligation was

totally unsecured. On December 18, 1954, two days prior to the opening of the Special Account, Arthur Desser, a member of Appellants, acting as an officer and director of the bankrupt corporation, participated in the meeting of the Board of Directors of the insolvent corporation at which meeting the Board authorized the termination of business operation and the filing of bankruptcy on behalf of the bankrupt corporation. The actual bankruptcy proceedings were commenced December 31, 1954. If there had been a transfer to Appellants, how could there be a more clear-cut example of a voidable preference within the meaning of Section 60a of the Bankruutcy Act?

As emphasized by the United States Supreme Court in the *Western Tie* case, *supra,* where the creditor had claimed a right to set-off, if the money had been applied to the debt "the necessary result of the transaction would have been to create a voidable preference."

> *Western Tie & Timber Co. v. Brown,* 196 U. S. 502, 508, 49 L. Ed. 571, 574.

However, as both Appellants and Appellee agree that there was no transfer of funds by the bankrupt to Appellants, the all-important question is: Just what is it that Appellants have which they claim a right to keep on the basis of an alleged right of "set-off"?

Conclusion.

The $3,217.68 held in the Jack L. Rau Special Account constituted property of the bankrupt corporation which Jack L. Rau held as Trustee of the bankrupt corporation. There is no mutuality of debts or credits between said trust fund held by Jack L. Rau and the obligation of the bankrupt corporation to Appellants.

The Referee committed no error.

The District Court committed no error in affirming the order of the Referee and approving and adopting the Referee's Findings of Fact and Conclusions of Law.

Appellee submits that the Order of the District Court should be affirmed.

Respectfully submitted,

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